COMMERCIAL LETTERS OF CREDIT.—A commercial letter of credit frequently takes the form of a letter written by a bank upon the application of the buyer of goods, requesting the seller to ship goods to the buyer and to draw upon the writer for the purchase price. Such a letter is termed a special letter of credit because addressed to a particular person.[1] A general letter, on the other hand, is addressed to anyone who chooses to act upon it.[2]

Even a very loose description of the commercial letter of credit at once suggests to the lawyer an offer contemplating a unilateral contract. If the letter is special, none but the offeree can bind the bank by complying with its terms.[3] If general, there is an analogy to an offer of a reward. Anyone who does the required act intending to accept the offer can bind the issuing bank.[4] It is therefore not surprising that many courts have adopted the offer theory.[5]

Where the letter purports to be revocable, the offer theory is perfectly satisfactory. The difficulty arises when a so-called "irrevocable" or "confirmed"[6] letter is issued. Let us suppose that a bank, at the request of the buyer, issues to the seller a letter of credit irrevocable for 60 days, requesting the seller to ship certain goods to the buyer. After the expiration of thirty days, for some reason of his own, the buyer orders the bank to revoke its offer and the latter duly communicates with the seller. If the seller has already shipped the goods, the bank is bound and the revocation is of course ineffective. If the seller has done nothing towards the performance of his contract with the buyer, *i. e.*, has not changed his position in reliance upon the letter of credit, there seems to be no great injustice in permitting the issuer to revoke. And to do so is in perfect harmony with the offer theory, for an offeror, merely by representing his offer to be irrevocable, does not make it so in the absence of some consideration binding him to keep it open. However, if the seller has changed his position by entering into other contracts or by commencing to manufacture goods, it seems highly inequitable to construe the letter as an offer contemplating a unilateral contract. The act requested being the shipment of goods, nothing short of actual shipment would entitle the seller to draw against the issuing bank.[7]

Boyle v. *Lysaght* (Ire. 1787) 1 Ver. & Scriv. 135, 1 Ridgeway's Cases in Parliament 384. The reversal by the House of Lords of a similar holding in *Murray* v. *Bateman* (1785) Ridgeway's Cases in Parliament, 187, resulted in the passage of Act 19 and 20, Geo. III (1779-1780). To the same effect, see the statute of 6 Edw. VII (1906) chaps. 5 and 6 and Scotch Small Landholders' Act of 1911, St. 1 & 2 Geo. V (1911) c. 49, sec. 32. Within recent years, in view of a housing situation similar to our own, a statute has been enacted protecting tenants from extortionate demands and ejectment without cause. St. 5 and 6 Geo. V (1915) chap. 97, sec. 1, subd. 3. In this country the courts, even in the absence of legislation, have granted renewals upon fair and equitable terms. See *Banks* v. *Hoskie* (1876) 45 Md. 207; *cf. Mitchell* v. *Reed* (1874) 61 N. Y. 123.

[1] See *Lafargue* v. *Harrison* (1886) 70 Cal. 380, 384, 9 Pac. 259. 2 Daniel, *Negotiable Instruments* (1913) 2009.

[2] *Ibid.*

[3] *Fletcher Guano Co.* v. *Burnside* (1914) 142 Ga. 803, 83 S. E. 935; *Lyon* v. *Van Raden* (1901) 126 Mich. 259, 85 N. W. 727.

[4] *Bank of Seneca* v. *First Nat. Bank of Carthage* (1904) 105 Mo. App. 722, 78 S. W. 1092.

[5] *Bank of Seneca* v. *First Nat'l. Bank of Carthage, supra,* footnote 4; *Lafargue* v. *Harrison, supra,* footnote 1; 2 Ames, *Cases on Bills & Notes* (1894) 783; Hershey, *Letters of Credit* (1918) 32 Harvard Law Rev. 1, 10, 19.

[6] These terms seem to be used interchangeably. A letter is said to be confirmed when the agent of the issuing bank notifies the seller that it will pay drafts drawn upon it according to the terms of the letter of credit. Whitaker, *Foreign Exchange* (1920) 170.

[7] It should be noticed that the seller cannot sue in quasi-contract, as

To save the offer theory, it seems possible to raise a contract implied in fact whereby the bank agrees to keep its offer open for sixty days if the seller will change his position in reliance thereon.[8] If such a collateral contract were implied, the bank would still have a power to revoke, it is true, but it would be liable in damages to the seller, who could complete his preparations, ship to the buyer, and sue the bank for breach of contract to keep the offer open. The measure of damages would be the amount of the draft drawn by the seller on the bank in accordance with the terms of the letter of credit. The difficulty here is that such collateral contracts are not usually implied to relieve the inequity of the situation raised when an offeree has not entirely complied with the terms of offer contemplating a unilateral contract.

The doctrine of estoppel has therefore been rushed in to fill the gap.[9] The letter of credit is treated as a representation that the bank has received money from the buyer to the use of the seller on certain conditions. And when the latter has acted in reliance upon such representation, the bank is estopped to deny it. The estoppel theory, as Mr. Hershey points out in a brilliant article,[10] meets the needs of the situation. The offer theory and the estoppel theory seem to be mutually exclusive, however, for the very essence of an offer is its revocability, and those acting upon it are charged with knowledge of that fact.

Still another theory may be suggested. In the law of bills and notes, if a third person gives consideration to the maker of a promissory note in exchange for his promise made to the payee, the latter can sue upon it, regardless of the fact that he furnished no consideration.[11] In some jurisdictions, the same rule has been applied to simple contracts.[12] This doctrine seems to meet the needs of the irrevocable letter of credit exactly. The buyer furnishes the consideration to the bank[13] in exchange for the bank's promise to the seller to honor his drafts on condition that the seller ship to the buyer in pursuance of the terms of the letter of credit.

The question then arises, exactly what must the seller do to acquire a right of action against the issuing bank? Certain conditions are usually set forth in the letter of credit. The goods must be shipped within a certain time, the bills of lading must be made out to the order of the shipper or the drawee bank, and the other documents must be properly drawn and attached to the draft. Of course in a contract for the sale of goods by description, the seller must not only ship within the specified time,[14] but must furnish goods of the kind, quantity and quality ordered by the buyer. If goods which do not answer the description are sent, the buyer may reject them.[15] Where the

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neither the buyer nor the bank has received any benefit. (1920) 20 Columbia Law Rev. 602.

[8] McGovney, *Irrevocable Offers,* (1913) 27 Harvard Law Rev. 644, 659.

[9] *Johannessen* v. *Munroe* (1899) 158 N. Y. 641, 53 N. E. 535.

[10] Hershey, *op. cit.* 19, 26.

[11] *Pierce* v. *Harper* (1918) 249 Fed. 867; *Crosier* v. *Crosier* (1913) 215 Mass. 535, 102 N. E. 901; *Farley* v. *Cleveland* (1825) 4 Cowen 432; 1 Williston, *Contracts* (1920) §§ 114, 354.

[12] *Hamilton* v. *Hamilton* (1908) 127 App. Div. 871, 112 N. Y. Supp. 10; *Rector* v. *Teed* (1890) 120 N. Y. 583, 24 N. E. 1014; *Palmer Sav. Bank* v. *Insurance Co. of North America* (1896) 166 Mass. 189, 44 N. E. 211. Professor Williston favors this view. 1 Williston, *loc. cit.*

[13] The buyer usually agrees to put the issuing bank in funds about 15 days before the maturity of the seller's draft. See the sample agreement in Margraff, *International Exchange* (1904) 92. So the contract would be bilateral.

[14] *Sunshine Cloak & Suit Co.* v. *Roquette* (1915) 30 N. Dak. 143, 152 N. W. 359; *Oshinsky* v. *Lorraine* (1911) 187 Fed. 120.

[15] *Peckham* v. *Davis* (1890) 93 Ala. 474, 9 So. 509; see *Patrick* v. *Norfolk*

offer from the buyer to the seller contemplates a unilateral contract, no contract comes into existence unless the seller exactly complies with the terms of the offer. Where the contract between the buyer and the seller is bilateral, substantial performance by the seller is a condition precedent to any duty on the part of the buyer to pay. It seems obvious that the buyer and the bank intend to honor the seller's drafts only in case he fulfills his obligations to the buyer. It would follow, therefore, that the seller must ship the goods ordered by the buyer within the time specified to gain a right of action against the issuing bank.

However, it is of paramount importance that the issuing bank be protected. It performs a remarkable service for both buyer and seller, enabling strangers in far corners of the world to deal with each other in comparative safety. As compensation for such services, the bank gets a small commission, frequently but a fraction of one per cent. The issuing bank should not pay the seller when it knows or ought to know that the seller has not met his contract with the buyer. But where the seller ships defective goods, thus entitling the buyer to reject them, the bank which pays in good faith should be protected so long as the seller's documents are in order. Accordingly, it is no defense to the buyer when sued by the issuing bank that the goods shipped were defective.[16] If, however, a comparison of the letter of credit and the bills of lading would have disclosed that the seller sent goods of a different description than ordered by the buyer, or sent them late, the issuing bank is not entitled to reimbursement, for it had notice.[17]

A seller who has shipped goods to a buyer naturally wants his money at once. He is able to get it by drawing on the issuing bank or its agent and selling the draft to his local bank, which discounts in reliance upon the letter of credit. It would be grossly unfair to require the discounting bank to do more than see that the documents of the seller are consistent with the terms of the letter of credit. It is under no duty to inquire whether or not the seller has fulfilled his contract with the buyer.[18]

It results, therefore, that an irrevocable letter of credit embodies a promise[19] by the issuing bank to the seller to honor drafts drawn according to the terms of the letter on condition that the seller ship the goods ordered by the buyer within the specified time. It also embodies a promise to *bona fide* holders to reimburse them for drafts drawn by the seller and discounted by the holders in reliance upon the letter of credit and other properly drawn documents, regardless of the state of the agreement between the buyer and the seller. And the buyer agrees with the issuing bank to reimburse it for *bona fide* payments of drafts drawn by the seller and backed by the proper documents, irrespective of whether or not the latter has shipped goods to the buyer. Indeed, in some cases, the buyer expressly exonerates the bank from liability

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Lumber Co. (1908) 81 Neb. 267, 272, 115 N. W. 780; 2 Mechem, *Sales* (1901) §§ 1155-1156.

[16] *Benecke* v. *Haebler* (1899) 38 App. Div. 344, 58 N. Y. Supp. 16, aff'd 166 N. Y. 631, 60 N. E. 1107; Whitaker, *op. cit.* 150.

[17] *Bank of Montreal* v. *Recknagel* (1888) 109 N. Y. 482, 17 N. E. 217.

[18] When a note is given for an executory agreement and a subsequent holder has knowledge thereof, he is under no duty to inquire whether or not the agreement has been performed. *Security Trust & Sav. Bank* v. *Gleichmann* (Okla. 1915) 150 Pac. 908; *Hakes* v. *Thayer* (1911) 165 Mich. 476, 131 N. W. 174.

[19] Assuming the theory above suggested that the buyer furnishes consideration in exchange for the bank's promise to the seller. According to the offer theory, the letter constitutes a mere offer. By the estoppel theory, the letter is considered a representation of fact.

where the documents are defective.[20] It seems, however, that the bank should bear any loss which it could have prevented by a more careful examination of the documents.

If the seller should ship nothing, but obtain bills of lading by collusion with the agent of the carrier, or should ship late, fraudulently alter the dates on the bills of lading, and then draw on the credit issuing bank or its agent and induce a *bona fide* purchaser to discount on the strength of the letter of credit, the purchasing bank would of course be in the precarious position of a *bona fide* holder of a draft backed by forged bills of lading. The issuing bank would not have to pay the draft unless it had accepted,[21] and if it did so, even in good faith, it seems that it would not be entitled to reimbursement from the buyer.[22]

Since a special letter of credit can be utilized only by the addressee, it would seem that a thief or a finder could reap no advantage from its possession.[23] However, suppose that a thief or a finder obtained bills of lading and other documents by fraud, forged a draft on the drawee bank, and induced another bank to discount it on the faith of the letter of credit. Here again the issuing bank could refuse to honor the draft with impunity unless it had accepted.[24] And if the issuing bank paid the draft in good faith, it seems that the buyer would not be compelled to reimburse it.[25] The bank could sue the fraudulent party in money had and received.

The questions discussed in this note were raised largely by three recent cases.[26] In *Higgins* v. *Steinhardter,* the plaintiff buyer had procured a letter of credit in favor of the defendant seller from the defendant bank. It was provided that the letter should expire November 7th, 1918. After that date, the seller shipped the goods, fraudulently obtained bills of lading showing shipment prior to November 7th, drew on the drawee bank, and sold the draft to an innocent purchaser. It seems that the draft was accepted by the agent of the issuing bank. The plaintiff buyer then brought a bill for an injunction

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[20] See the sample letter in Whitaker, *op. cit.* 151.

[21] A *bona fide* holder of forged bills of lading can compel the acceptor of the draft to pay at maturity. *Goetz* v. *Bank of Kansas City* (1887) 119 U. S. 551, 7 Sup. Ct. 318. But it would seem that a letter of credit is not equivalent to an acceptance.

[22] A drawee who has paid a draft to a *bona fide* holder in reliance upon forged bills of lading cannot recover back his money from the latter upon discovery of the forgery. *Springs* v. *Hanover Nat'l Bank* (1913) 209 N. Y. 224, 103 N. E. 156. Since the issuing bank cannot recover from the discounting bank, it seems that it cannot compel the buyer, an equally innocent party, to reimburse it. However, it might be argued that the buyer should be held on the ground that he is the *entrepreneur.* He gets the profits and should bear the risk of loss, the issuing bank being but a conduit pipe, a convenient means of paying the seller.

[23] A thief or a finder of a negotiable instrument has a power to pass a good title to an innocent purchaser for value. Negotiable Instruments Law §§ 16, 56. The Uniform Sales Act (§ 32) gives a thief or a finder no power to negotiate a bill of lading. The rule is otherwise under the Bills of Lading Act (§ 31).

[24] See *National Park Bank* v. *Ninth National Bank* (1871) 46 N. Y. 77, 80.

[25] By the doctrine of *Price* v. *Neal* (1762) 3 Burr. 1354, a drawee who has paid a *bona fide* holder of a draft upon which the drawer's name is forged cannot get his money back. This being so, it is difficult to see how the issuing bank can hold the buyer. See *supra,* footnote 22.

[26] *Higgins* v. *Steinhardter* (1919) 106 Misc. 168; *American Steel Co.* v. *Irving Nat'l Bank* (C. C. A. 2nd Cir. 1920) 266 Fed. 41; *Frey* v. *Sherburne Co. & The Nat'l City Bank* (193 App. Div. 849, 1st Dept. 1920) 184 N. Y. Supp. 921. See also *Gambrill Mfg. Co.* v. *Sherbourne Co. et al.* (App. Div. 1st Dept. 1920) 184 N. Y. Supp. 912.

to restrain the issuing bank from paying the drafts and an injunction *pendente lite* was granted. This decision seems erroneous. The discounting bank was entitled to be paid by the issuing bank and the latter by the buyer. The buyer should have been forced to pursue his remedy against the seller. If the bills were forged, however, the bank could not compel the buyer to reimburse it, but would have to go against the seller.[27]

In the case of *American Steel Co.* v. *Irving National Bank*, the buyer procured a letter of credit from the defendant bank in favor of the plaintiff seller. The statement of facts and the opinion are very ambiguous and it is not clear whether it became impossible for the buyer or the seller or both to perform the sales contract. At any rate, in an action by the seller against the bank for refusing to honor drafts drawn in accordance with the letter of credit, the court *held* that the contract between the seller and the bank was distinct from and independent of the contract between the buyer and the seller and that the fact that the contract of sale was impossible of execution did not affect the bank's liability to the seller. Judgment was accordingly awarded to the plaintiff. It seems that even though it became impossible for the buyer to perform, the seller could still ship,[28] draw on the issuing bank, and demand payment. If, however, performance on the seller's side was impossible, it is difficult to see how the seller could hold the bank, for the duty of the latter to pay is conditioned upon the seller's shipping goods.

In the case of *Frey* v. *Sherburne Co. and the National City Bank*, the plaintiff buyer contracted to purchase sugar from the defendant seller. The sugar was to be sent in five shipments and if any shipment was delayed the buyer was to have the privilege to cancel that portion of the contract or to accept the late shipment and waive damages. The buyer procured an irrevocable letter of credit from the defendant bank in favor of the seller in which the conditions set forth were the same as those in the sales contract except that the buyer's privilege to cancel was not mentioned. The first shipment was not made in July as the contract and the letter of credit required, and the buyer elected to cancel that portion of the contract. The issuing bank declared its intention to pay the seller when the latter should draw, however, and the buyer brought a bill for injunctions to restrain the seller from drawing and negotiating drafts and to restrain the bank from paying drafts which might be in the hands of third persons. The injunctions were properly refused, the case of *Higgins* v. *Steinhardter* being expressly overruled.

The letter of credit having expired so far as the first shipment was concerned, the seller could not compel the issuing bank to honor its draft for the purchase price. And any discounting bank would have notice by comparing the letter of credit with the bills of lading and would hence have no claim against the issuing bank. There was, of course, the possibility that the seller might fraudulently obtain bills of lading showing shipment within the specified time, as in *Higgins* v. *Steinhardter*. If the buyer could show fraud on the part of the seller coupled with a threat to negotiate to an innocent purchaser for value, an injunction might be granted upon analogy to the cases where a fraudulent payee of a promissory note is uniformly enjoined from negotiating

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[27] See *supra*, footnote 22. In some jurisdictions, the bank would also have an action against the carrier. *Bank of Batavia* v. *N. Y., etc., R. R.* (1887) 106 N. Y. 195, 12 N. E. 433; 1 Mechem, *Agency* (2nd ed. 1914) § 759.

[28] Providing the letter was irrevocable or, if revocable, had not been revoked. Space forbids a consideration of the effect of the buyer's insolvency upon the rights of the seller and the issuing bank.

it.[29] However, no fraud was alleged or proved in the *Frey* case. Turning to the prayer for an injunction to restrain the payment of drafts in the hands of third parties, it seems clear that the issuing bank would not be liable to such third parties, for the discrepancies between the bills of lading and the letter of credit would constitute notice. If this be so, an injunction was unnecessary, for if the issuing bank chose to pay, it would do so at its peril. If it be assumed that the seller was guilty of fraud, an injunction against innocent third parties would be out of the question. If, however, there was forgery, the third parties would have no claim against the issuing bank unless the latter had accepted; and in such a case, the buyer would not be compelled to pay the bank. So an injunction would be unnecessary.

While it is unquestionably true that the contract of sale and the contract between the issuing bank and the seller constitute two separate and distinct contracts, they are not altogether independent, nor does it seem reasonable to assume that the parties intended them to be so. To enable the seller to recover from the bank, he must at least get documents which show that he has shipped goods according to the terms of the letter of credit, which are usually the same as those of the contract between the buyer and the seller. He must produce some evidence that he has performed his agreement with the buyer.

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[29] *Warnock Uniform Co.* v. *Silver* (1915) 170 App. Div. 674, 156 N. Y. Supp. 637; *Atkinson* v. *Cain* (1907) 61 W. Va. 355, 56 S. E. 519; 2 High, *Injunctions* (1905) 1108. If the bills were forged, however, there would seem to be less ground for an injunction for the issuing bank would not ordinarily be bound to pay the discounting bank.